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In the Supreme Court of the United States

OCTOBER TERM, 1978

SEARS, ROEBUCK AND CO., PETITIONER

v.

COUNTY OF LOS ANGELES AND CITY OF COMPTON

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's invitation of June 4, 1979.

OPINIONS BELOW

The order of the trial court is not officially reported. The opinion of the Court of Appeal (Pet. App. 1-29) is reported at 85 Cal. App. 3d 763. The denial by the Supreme Court of California of a petition for hearing (Pet. 2) is reported at 149 Cal. Rptr. 764.

JURISDICTION

The decision of the Court of Appeal was entered on October 25, 1978 (Pet. 2; Pet. App. 1). The Supreme Court of California denied petition for hearing on

January 17, 1979 (Pet. 2). The petition for a writ of certiorari was filed on April 16, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(3).

QUESTION PRESENTED

The United States will discuss the following question: Whether the California property tax exemption for personalty manufactured or produced (1) outside California and brought into the State for transshipment out of the United States; or (2) outside of the United States, and brought into California for transshipment out of the State, for sale in the ordinary course of trade or business, is invalid under the Commerce Clause of the United States Constitution.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes".

Sections 225 and 225.1 of the Cal. Rev. & Tax. Code (West), enacted by 1975 Cal. Stats., ch. 1126, at 2746, §§ 1 and 2, during the period here involved,[1] provided as follows:

> §225. *Personalty brought into state for transshipment outside state or United States; exemption*
>
> Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.
>
> §225.1. *Method of claiming transshipment exemption*
>
> A person claiming the transshipment exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

[1] Although Section 225.1 of the Cal. Rev. & Tax. Code (West) was repealed by 1977 Cal. Stats., ch. 246, §4, its provisions were simultaneously reenacted as Section 253.10 of the Rev. & Tax. Code, by 1977 Cal. Stats., ch. 246, §7.

STATEMENT

Petitioner brought this suit for refund of ad valorem personal property taxes paid under protest to the County of Los Angeles and the City of Compton.

The facts were stipulated (Pet. App. 1-2, 4) and may be summarized as follows: Petitioner is engaged in the business of selling goods at retail, both in California and

elsewhere. On March 1, 1976, the tax lien date for purposes of the annual California ad valorem tax on personal property, petitioner held tangible personal property in warehouses in the County of Los Angeles and City of Compton. The property in question had been manufactured or produced outside the United States, and had been imported by petitioner and placed in warehouses for distribution both within and without California for purposes of sale in the ordinary course of petitioner's business. Petitioner's distribution warehouses in the County of Los Angeles were devoted almost entirely to goods imported from foreign countries, particularly from locations in the Pacific area. The rate of turnover at the warehouses averaged approximately three times per year. Petitioner intended to ship the goods as quickly as its distribution operations permitted. Pursuant to Sections 225 and 225.1 of the California Revenue and Taxation Code, petitioner applied to the total amount of goods manufactured or produced outside the United States and held in its warehouses in Los Angeles County on March 1, 1976, the fraction represented by the out-of-state shipments from those locations during the preceding year divided by the total shipments from those locations during that year. Petitioner accordingly claimed a transshipment property tax exemption for property having a value of $19,373,089 (Pet. App. 1-3, 4-5).

Respondents denied the claimed exemption. They asserted (1) that properly construed, Section 225 exempted only goods in transit through the State, and (2) that even if Section 225 were construed to exempt imported goods held in the State by the owner for disposal or use, it would violate the United States Constitution by regulating interstate and foreign commerce in interfering with foreign affairs, because it extended no exemption to interstate goods. Petitioner

thereupon paid the tax under protest and instituted this action for refund in the Superior Court of Los Angeles County. The Superior Court upheld petitioner's claimed exemption (Pet. App. 1-2, 5-6).

The Court of Appeal reversed (Pet. App. 29). Although it rejected respondents' statutory argument that Section 225 applied only to goods "in transit" (Pet. App. 7-10), it held that the statutory exemption of foreign goods regulated interstate and foreign commerce and was therefore invalid under the Commerce Clause of the United States Constitution (Pet. App. 6, 10-18). It also suggested that the exemption interfered with the power of the Congress to impose tariffs (Pet. App. 15-16). In the Court of Appeal's view, the statutory exemption gave goods of foreign origin a competitive advantage over goods manufactured in other states and brought to California for transshipment in interstate commerce. It concluded that "state taxes which discriminate between classes of interstate and foreign goods on the basis of their origin are not permitted" (Pet. App. 14). With three Justices dissenting, the Supreme Court of California denied a petition for hearing (Pet. 2).

ARGUMENT

In holding that the California property tax exemption for foreign goods destined for interstate commerce or out-of-state goods destined for export violates the Commerce Clause of the Constitution and interferes with Congress' power to impose tariffs, the Court of Appeal misinterpreted the decisions of this Court.

1. Section 225 of the California Revenue and Taxation Code exempts from taxation while held in California, imported goods destined for other states and goods from other states destined for export. It does not, however,

exempt domestic goods destined for interstate commerce. On the authority of this Court's decision in *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977), the Court of Appeal held that the statute unconstitutionally discriminated against interstate commerce and therefore violated the Commerce Clause. But *Boston Stock Exchange* has no bearing on the question presented in this case. The prohibited discrimination in that case was one that provided "a direct commercial advantage to local business" by virtue of "laws that favor local enterprise at the expense of out-of-state business" (429 U.S. at 329) by taxation "in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state business" (*id.* at 335).

Here, in contrast, the statutory property tax exemption did not favor local business at the expense of out-of-state business. It favored imports and exports.[2] There is, however, no constitutional prohibition against favoring imports over domestic goods. The Import-Export Clause of the Constitution itself makes such a differentiation. The decisions of this Court have therefore consistently held invalid state statutes that have had an adverse impact upon foreign nationals or upon foreign commerce.[3] Nor

[2]Cf. *Allied Stores of Ohio* v. *Bowers*, 358 U.S. 522 (1959). There, the issue was addressed under the Equal Protection Clause of the Fourteenth Amendment rather than under the Commerce Clause.

[3]See, *e.g.*, *Ware* v. Hylton, 3 U.S. (3 Dall.) 199 (1796); *Fairfax's Devisee* v. *Hunter's Lessee*, 11 U.S. (7 Cranch) 603 (1813); *Brown* v. *Maryland* 25 U.S. (12 Wheat.) 419 (1827); *Henderson* v. *Mayor of New York*, 92 U.S. 259 (1875); *Chy Lung* v. *Freeman*, 92 U.S. 275 (1875); *Hauenstein* v. *Lynham*, 100 U.S. 483 (1879); *People* v. *Compagnie Gen. Transatlantique*, 107 U.S. 59 (1882); *Asakura* v. *Seattle*, 265 U.S. 332 (1924); *Nielsen* v. *Johnson*, 279 U.S. 47 (1929); *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414 (1940); *Hines* v. *Davidowitz*, 312 U.S. 52 (1941); *Kolovrat* v. *Oregon*, 366 U.S. 187 (1961); *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964); *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964); *Zschernig* v. *Miller*, 389 U.S. 429 (1968).

does the Commerce Clause require a different result. As this Court reaffirmed in *Washington Rev. Dept.* v. *Stevedoring Assn*, 435 U.S. 734, 751 (1978), "[T]he Import-Export Clause states an absolute ban, whereas the Commerce Clause merely grants power to Congress." See also *Richfield Oil Corp.* v. *State Board*, 329 U.S. 69, 75 (1946).

When only the Commerce Clause is involved, this Court only last Term in *Japan Line, Ltd.* v. *County of Los Angeles*, decided April 30, 1979 (No. 77-1378), explicitly rejected the premise that "Commerce Clause analysis is identical, regardless of whether interstate or foreign commerce is involved. * * * When construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required." (Slip op. 11-12). *Japan Line* held that shipping containers employed in foreign commerce, based and owned in Japan, were not subject to the apportioned property taxation to which domestic shipping containers engaged in interstate commerce would have been subject.[4] Although this Court in *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276 (1976), held that a state was not constitutionally required to exempt imports held in the original package from generally imposed property taxation, nothing in the decision suggested that the exemption that had previously been constitutionally required under decisions overruled by *Michelin Tire* was thereafter constitutionally prohibited.

As the Court in *Michelin Tire* pointed out (423 U.S. at 283-294), the considerations underlying the Import-Export Clause were that the federal government speak with one voice in regulating commercial regulations with

[4]See *Ott* v. *Mississippi Barge Line*, 336 U.S. 169 (1949); *Braniff Airways* v. *Nebraska State Board*, 347 U.S. 590 (1959).

foreign governments, that import revenues not be diverted to the states, and that seaboard states with ports of entry not be permitted to be toll-takers at the expense of states not situated as favorably geographically. The California statute serves all of these purposes. The fact that it serves and advances constitutional policy somewhat more fully than the minimum required of the state[5] does not justify the Court of Appeal's ruling that it violates the Commerce Clause.

During the more than 100 years prior to the *Michelin Tire* decision, while the rule of *Low* v. *Austin*, 80 U.S. (13 Wall.) 29 (1871) and *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652 (1945), required exemption of imported goods in original packages from generally imposed state property taxes, the Court consistently held that goods that had moved in interstate commerce in their original packages enjoyed no comparable exemption.[6] When the Court overruled *Low* and *Hooven*, it was not on the basis of any discrimination favoring imports over goods in interstate commerce, but only because the considerations that gave rise to the Import-Export Clause did not require

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[5]Even before the *Michelin Tire* decision, the California exemption was somewhat broader than the minimum then constitutionally required. By its terms, the exemption for imports persisted beyond the original package, for it permitted breaking bulk, repackaging, etc. With regard to goods held for export, it granted exemption prior to movement in the stream of exportation, as defined by this Court's decisions in *Empresa Siderurgica* v. *Merced Co.*, 337 U.S. 154 (1949) and *Joy Oil Co.* v. *State Tax Comm'n.*, 337 U.S. 286 (1949). It is not questioned, however, that the goods exempted from tax were goods that had been imported and goods that were subsequently exported.

[6]*Woodruff* v. *Parham*, 75 U.S. (8 Wall.) 123 (1868); *Brown* v. *Houston*, 114 U.S. 622 (1885); *American Steel & Wire Co.* v. *Speed*, 192 U.S. 500 (1904); *Sonneborn Bros.* v. *Cureton*, 262 U.S. 506, 509, 510-513 (1923); *Wiloil Corp.* v. *Pennsylvania*, 294 U.S. 169 (1935).

exemption. Nothing in *Michelin Tire* suggested that the pre-existing exemption was now to be constitutionally prohibited.[7]

In sum, the decisions of this Court involving imports, exports, and foreign commerce uniformly emphasize that one of the principal purposes of the Constitution was to assure that the states did not impede or obstruct importation, exportation, or foreign commerce. The Court in *Michelin Tire* overruled *Low* v. *Austin* only when it was demonstrated that application of a generally imposed property tax to imports in the original package did not substantially impede importation or foreign commerce. *Washington Rev. Dept.* v. *Stevedoring Assn.*, 435 U.S. 734, 751-755 (1978). By favoring imports and exports, Section 225 of the California Revenue and Taxation Code facilitates importation and exportation and assures that imports and exports passing through the state will not be impeded even to the extent of the impact of a generally applicable property tax. While such action

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[7]Indeed, in contexts other than property taxes on goods in the original package, the Court has treated imports or exports markedly differently from goods shipped in interstate commerce. Compare *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964) and *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964) with *State Board* v. *Young's Market Co.*, 299 U.S. 59 (1936) and *Brewing Co.* v. *Liquor Comm'n.*, 305 U.S. 391 (1939); *Crew Levick Co.* v. *Pennsylvania*, 245 U.S. 292 (1917) with *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250 (1938); *Carson Petroleum Co.* v. *Vial*, 279 U.S. 95 (1929) with *General Oil Co.* v. *Crain*, 209 U.S. 211 (1908), *Bacon* v. *Illinois*, 227 U.S. 504 (1913), and *Minnesota* v. *Blasius*, 290 U.S. 1 (1933).

Carson Petroleum Co. v. *Vial*, *supra*, may have been heavily qualified by the decision in *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949), as the dissent in the latter case asserted (337 U.S. at 291-292). But the result in *Carson Petroleum* was distinguished from other contemporary decisions principally by the fact that the oil involved was destined for export (see 279 U.S. at 106-109).

may not be constitutionally required, it is not, as the decision below erroneously held, constitutionally prohibited. Nothing in the Commerce Clause prevents a state from favoring imports and exports beyond the extent required by the Import-Export Clause.

2. a. In further support for its invalidation of the statutory exemption for imported goods, the Court of Appeal suggested (Pet. App. 15-16) that Section 225 impedes the power of the Congress to determine the effective tariff applicable to imported goods. But this reasoning is contrary to this Court's analysis in *Michelin Tire*. In considering the effect of removing the exemption for imported goods required by earlier decisions, the Court pointed out (423 U.S. at 287): "It may be that such taxation could diminish federal impost revenues to the extent its economic burden may discourage purchase or importation of foreign goods. The prevention or avoidance of this incidental effect was not, however, even remotely an objective of the Framers in enacting the prohibition."

b. Furthermore, Sections 4271 and 4272 of the Internal Revenue Code of 1954 show that the California exemption for imports and exports is entirely consistent with congressional policy. Section 4271 imposes a tax of 5 percent upon the amount paid for transportation of property by air, but Section 4272(a) limits this to "transportation by air which begins and ends in the United States." Section 4272(b) excludes from tax, under regulations prescribed by the Secretary, "transportation of property in the course of exportation * * * by continuous movement, and in due course so exported."

Under Treasury Temporary Regulations in Connection with the Airport and Airway Revenue Act of 1970 (26 C.F.R.), Section 154.2-1(c)(1) and (2), transportation will

be considered to begin and end at the points of origin and destination as shown by a through airwaybill, or, if no such airwaybill has been issued, then the export or import character of the shipment may be shown by a contract or other written evidence showing the beginning point and ending point of air transportation. And Section 154.2-1(c)(1) of the Regulations is explicit in providing that transportation from a point outside the United States to a point inside the United States will not be considered broken "even though there may be stopovers in the United States (such as, for example, to consolidate cargo at a 'gateway' city)."

With regard to exports, the tax is not applicable to the segment of air transportation in the United States even though the mode of transportation in export is other than by air. Section 154.2-1(d)(1) of the Regulations provides:

> For example, the tax does not apply to air transportation from Chicago to New York if the property is in the course of exportation, by continuous movement, by boat from New York to Europe and in due course is so exported. Delays caused by circumstances beyond the control of the shipper (such as labor disputes or natural disasters) will not interrupt continuous movement. Property arriving at a gateway city by air may be repacked or consolidated with other property without interrupting continuous movement.

Under Section 154.2-1(d)(3) of the Regulations, payment of the tax may be deferred for six months to establish the fact of export "in due course" within that period. Proof of export received after six months will establish a ground for refund of the tax paid.

The foregoing provisions show that even when the facilities of the airways of the United States are employed,[8] Congress has exempted from the air transportation excise tax goods that are in fact imports and exports, and has provided flexible rules permitting stopovers, repackaging, and consolidation of cargo in the course of movement without loss of exemption. California's removal of property tax burdens upon imports and exports is therefore entirely consistent with congressional policy.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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[8]Cf. *Massachusetts* v. *United States*, 435 U.S. 444 (1978).

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